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Session 7: The Asia-Pacific Role in the New Global Economic Order May 13, 2009

CHARLES E. MORRISON, President, East-West

Center: I think it's very appropriate to end the conference with this particular topic, the Asia-Pacific role in the new global order. In fact, this is what it's all about—our leadership capability as a region. We all know the fundamental dilemma in the international system, which is that while the issues are global, the decision-making structures are still at the national level. And so it takes countries and regions to lead.

The Asia-Pacific region has the structural power that was once held by the Atlantic region. But as was pointed out yesterday during Session 4, the institutional arrangements still reflect that trans-Atlantic world of the early Cold War period.

The question is also whether we have the strategic vision to lead and the mentality of looking beyond our own national interests to consider how those interests translate into a set of global interests. That's what gives nations moral authority for leadership, when they can see beyond their own national interests.

We'll start with our panel, who include The Hon. Cheng Siwei, who is a former Vice Chair of the Standing Committee of the National People's Congress. We then will move to Dr. Fred Bergsten, Director of the Peterson Institute for International Economics, and then to Dr. Masahiro Kawai, Dean of the Asian Development Bank Institute.

CHENG SIWEI, formerly Vice Chairman, Standing Committee of the National People's Congress, China:

Good morning, ladies and gentlemen. Before we talk about our role in the new economic order, we have to get consensus on what the new economic order is after the financial crisis. According to ancient Chinese philosophy, the best strategy is balancing and compromising. So, a good thing will turn to bad by overdoing it.

Rebalancing

In my opinion, we have to pay attention to the following six balances. First, it's the balance between saving and spending. I always tease my American friend. I say, "You guys borrow tomorrow's money and spend tomorrow's money for today, and we Chinese save today's money for tomorrow.

That's why you have the financial crisis." But actually, I think we need to balance saving and spending.

The Eastern people should save less and spend more, and the Western people should save more and spend less, so then we can get a better balance.

Second, as a consequence of the first balance, we have to balance between our domestic demand and exports. The Eastern countries have to change their economic growth mode, from export-oriented to domestic consumption-oriented.



Hon. Cheng Siwei, formerly Vice Chairman, Standing Committee of the National People's Congress, China

Increasing Purchasing Power

But this is not an easy transition, because the most important thing is to increase the purchasing power of the people. In this case, we need to do a lot of things, including raising the salaries and small benefits for the employees. We need to build up credit systems so we can raise the purchasing power of the people, and then we can shift from export-oriented to domestic-oriented.

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Some people say that the easiest way is just to appreciate the RMB [*renminbi*]. I don't think so, because the consumer goods portion of our imports accounts for less than 20 percent. Increasing the exchange rate only affects international purchasing power. What we want to do is to increase the domestic purchasing power.

Financial Innovation/Supervision

Third, we need to balance financial innovation and financial supervision. As you know, financial derivatives represent a double-edged sword. On the one hand, they can mitigate financial risks. On the other hand, they can be used as a tool of speculation.

So, financial innovation and financial supervision are mutually supplementary, and also mutually restricting. In this case, we need to encourage financial innovation, and we need to prevent over-speculation in the financial derivatives market. Specifically, I think we need an international effort aimed at preventing over-speculation in financial innovation.

Fictitious/Real Economy

Fourth, is the balance between the fictitious economy and real economy. One of my many hats is serving as president of Research Center on Fictitious Economy and Data Science in the Chinese Academy of Sciences. The real economy is mainly based on tangible resources, and the fictitious economy is based on intangible resources, mainly, credit systems.

When you lend money or buy stocks or bonds, you lose the right to use your money; you only keep the right of ownership of your money. But your right of ownership is based on credit systems. If the credit system broke, you cannot get your money back, right. The stocks and bonds are only paper, without the backup of the credit systems.

That's what we have seen now in the financial crisis. We need to balance these two, not only by making money through high rates or return. These high rates, on the one hand, mean high efficiency, so you can borrow others' money and use it to make more money. But on the other hand, it also means high risk. If your return is one percentage above the interest rate, you will gain. But if it's lower than one percentage of the interest rate, you will be in trouble. In the latter case, you will have a liquidity problem, because you don't have the money to pay back.

A central bank cannot just focus on inflation as the sole objective of their monetary policy. This is because the fictitious economy, like the stock market and the housing market, can absorb liquidity. The inflation rate can appear to be low when the housing and stock markets are booming, as happened in United States in 2002-2006. But if the winds change, the stock market and the housing market

will release the liquidity to the markets, which will cause a serious inflation problem. That's what we must take into account with respect to the fictitious economy.

Sustainable Development/Economic Growth

Fifth, is the balance between sustainable development and economic growth. At the World Economic Forum meeting last year, I said that climate change would be more important than the financial crisis in the long term.

I'm very glad to see President Obama take a more active attitude with respect to new energy sources. In my view, by developing new energy sources, we can kill three birds with one stone.

First, we can reduce the pressure of petroleum demand, by developing new energy sources. Second, can reduce the CO2 emissions and tackle the climate change problem. Third, we can make biofuels from cellulose and semi-cellulose, rather than from corn or sugar cane, so we can have more land to grow food for the people. I think it is very important to develop new energy sources. And new energy sources may be a central part of the next industrial revolution.

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Climate Change Cooperation

Yesterday, we talked about the G2 among other topics. In my opinion, the United States and China are the two largest CO2 emitters. It is our responsibility to cooperate and solve this problem. So although China is a developing country, our accumulated CO2 emission is only 9 percent of the total, and our CO2 emission per capita is lower than the world average. But we should not use this as an excuse for not assuming responsibility and cooperating with other countries to solve the climate change problem.

New Energy Sources Plan

Currently, we are formulating a new long-range plan on new energy sources. This is a very difficult task because at this time the installation capacity of our electricity sector is around 700 million kilowatts, and 70 percent of that is from coal. By the year 2020, I think our total installation capacity will be 1.4 billion kilowatts, and we would like to reduce the coal percentage to around 50 percent. That means we will put a lot of effort into developing nuclear, wind, and solar power, and biofuels.

China's nuclear power currently generates only about

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10 million kilowatts. By 2020, we will raise it to 40 million kilowatts. Wind power now generates about 10 million kilowatts, and we would like to increase that to 100 million kilowatts by 2020. Solar energy now generates about 1.5 million kilowatts, and by 2020 we would like to increase that to 5 million kilowatts.

We also have an energy-saving program. By 2010, China will reduce our energy consumption per GDP by 20 percent. That means we are seriously taking measures to deal with climate change and to develop new energy sources. This is a must for the sustainable development of the entire world.

Regional Integration/Economic Globalization

Finally, we need to maintain a balance between regional integration and economic globalization. In 2005, at the 15th PECC conference in Seoul, I said that regional integration is parallel with economic globalization, and they are mutually complementary. So, that's why you have NAFTA or you have European Union.

China is taking an active attitude with respect to regional integration as well as economic globalization. As you know, the China and the ASEAN countries—the so-called 10 + 1—will have Free Trade Zone next year. In addition, we are promoting 10+2 and 10+3, so I think that regional integration in Asia will proceed along with the financial crisis.

Those are my preliminary thoughts about the new economic order and what China can contribute in the future. But I must apologize for being not able to answer your questions, because I have to catch the 1:30 p.m. flight to Canada. Thank you very much for attention, and looking forward to seeing you next time.

C. FRED BERGSTEN, Director, Peterson Institute for International Economics: I've decided to take a more literal interpretation of the topic—the move to a new world order. I will address five or six major implications of that, particularly for the Asia-Pacific countries, as we try to cooperate and promote an evolution that will move toward a more effective and more successful international economic system.

It's important to realize at the outset of that discussion that the world is already moving rapidly toward what I would call a new global economic order. The crisis has accelerated a number of trends that were already underway or being discussed. But certainly it has promoted some major reforms, in both the substantive [policies] of international institutions and the organizational elements thereof.

I will put all this in the context of a world that is rapidly evolving now toward a new order. In addition, I will try to suggest how we can draw on that evolution and its

possible future prospects to further strengthen Asia-Pacific cooperation, both for purposes of transpacific comity itself, but also to strengthen the world economy, and world relations more broadly.

G20's Rise

The first key institutional development that has been fostered by the crisis is the substitution of the G20 for the G7 as the main steering committee for the world economy.

The G20 already had existed at the Finance Minister's level for 10 years and had played a useful but supplementary role to the G7.

Now, with the crisis, the G20, at the summit level, has been established as the main decision-making focus for global economic activity. It's not absolutely firm that that will continue at the summit level forever—a third meeting will take place in New York in September—but I think it's almost certain that G20 Summits probably will continue on an annual basis after the crisis period and essentially replace the G7 as the central institutional ele-



Dr. C. Fred Bergsten, Director,
Peterson Institute for International
Economics

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ment for global economic coordination, and global economic strategy.

That has a huge implication for the Asia-Pacific countries and their relationships. The G7 had one Asian country, Japan. The G20 has four to six Asian countries, depending how you define it.

Asia Pacific Roles in G20

Obviously, it includes Japan, China, Korea, and Indonesia. It also includes Australia and India. So, depending whether you want to use an APEC focus, a 10 plus 3, a 10 plus 6, however you want to define "Asia," there has been a quantum expansion in the participation of Asia in the global steering committee. As I emphasized yesterday, that will be dramatized as Korea takes the chair of the G20 in 2010.

There was some speculation on yesterday's panel

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about the next G20 meetings. As I mentioned, the next summit will be in New York, hosted jointly by the United States and the UK. But it will be taking place around the U.N. General Assembly, because the leaders happen to be in New York at that time.

I have every expectation that the next G20 Summit will be hosted by Korea, in Seoul, at some point in early 2010. That will then dramatize the ascension of non-Japan Asia and the broadening of Asian leadership of the global economic process, with Korea in the chair, directing the process, and taking a very overt lead in that whole system.

Asia Pacific Caucus

The second point I'd like to make, stemming from the first, is that one way to maximize the contribution of the G20 role to Asia-Pacific cooperation would be to create an Asia-Pacific caucus within the G20. There are already several caucuses within the G20. The G7 essentially now becomes a caucus of the rich countries within the G20, and I think that will be increasingly recognized as its role, both at the summit level and at the finance minister's level.

The BRICs [Brazil, Russia, India, and China] are caucusing; the four BRICs are now meeting each time prior to a G20, in order to coordinate their positions of the lead emerging markets.

So, if we wanted to build on the APEC experience and the concepts that underlay the desire to foster stronger ties across the Pacific, one possibility would be for the nine or ten countries from the Asia-Pacific region to meet prior to the G20 Summits. I say nine or ten because India technically is not a member of APEC, but probably would be included in an Asian component of the caucus. Fully half of the group could caucus in an Asia-Pacific context.

Revitalization of IMF

The third big change, which I addressed in my comments yesterday, is the revitalization of the International Monetary Fund (IMF). Comments from some of my colleagues on the panel yesterday suggested that the IMF is not fully approved or beloved by all Asian countries, or even Asian economists.

But, the fact is, that the G20 at its last summit—and with the full participation of all these Asian countries—launched an enormous renewed expansion of the role of the IMF in the world system. The G20 provided another \$500 billion of lending capability, created \$250 billion of special drawing rights, and gave it new mandates on macroeconomic surveillance, and financial supervision surveillance.

If you read the London Summit communiqué, virtually every section has a major new mandate for the International Monetary Fund. We have to see if it's up to the task, but certainly it has been given the opportunity to play a huge role.

Changes to Monetary System

I also would like to focus on the monetary aspect of the new economic order. Our Chinese friends and others have suggested that we think about moving away from a dollar-based system to a system based on an international asset, particularly, the IMF's Special Drawing Rights (SDRs).

Governor Zhou Xiaochuan of the People's Bank of China, has outlined this in some detail, in speeches and papers. A number of other countries have supported the idea of reducing the dominant role of the dollar in the monetary system, and moving toward a more internationally created and managed asset.

It may surprise all of you to hear that I have a lot of sympathy for that idea. For the reasons I mentioned yesterday, the impact on the United States of the dollar's international role is quite ambivalent. There are short-run benefits from being able to finance your external deficits with your own currency. But when you then pile up massive foreign debt and have to run deficits as a result, it may badly undermine your economy, as we are seeing in the current crisis. I think the United States should be quite open to discussing the creation of supplementary international monetary assets, as suggested by Governor Zhou Xiaochuan.

Expanded Use of SDRs

What the G20 did in London moves substantially in that direction. The IMF special drawing rights [SDRs] were created way back in the 1960s with strong U.S. support to provide a supplement to the dollar, and to provide a broader-based and potentially more stable monetary system.

Unfortunately, up until this point, the SDRs have been a very minor element in the world economy. They constitute less than 1 percent of global reserves. The decision at London, to create \$250 billion of additional SDRs, would immediately jump the amount of SDRs tenfold, and at least take it up to about 5 percent of global reserves—still a minority, but starting to be serious. And so, again, a step already underway is moving us in the direction of a new economic order.

I believe we should be thinking of creating about a \$1 trillion of SDRs over the next few years to head off the new mercantilism that I talked about yesterday, but also to provide a more broadly based, diversified global monetary system for the future. Interestingly, Zhou

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Xiaochuan, in his famous speeches and papers, has made one very specific proposal that would move in that direction.

He did not use the term, but the last paragraph of his famous paper proposes creating a substitution account at the International Monetary Fund, into which monetary authorities who are unhappy holding too many dollars could convert those dollars into SDRs, in totally off-market transactions that would have no adverse effect on global financial stability.

If China or Japan or any other big dollar holder, sought to move out of dollars into euros or yen or some other currencies, there would be a big impact on exchange rates, global financial stability, market psychology, and the like, and that's a big deterrent to their doing so. What you therefore have is kind of a balance of mutual terror, where we know the Chinese and others are unhappy with the amount of their dollar holdings.

IMF Substitution Account

The Americans and others don't think they'll actually try to convert anything and so don't worry too much about it. But if there was an error of calculation, or some political disturbance that led to monetary responses, the global financial system could be badly disrupted. And so, it seems to me, that Zhou Xiaochuan's idea is a very good one. Create a substitution account at the IMF and permit totally off-market reserve diversification that would minimize global financial and economic risk.

The idea of creating a substitution account was negotiated for two-and-a-half years in the International Monetary Fund in the late 1970s when there was also a wave of anxiety about the stability of dollar holdings in the global economy. It came very close to fruition. It floundered on some technical issues, and the renewed strengthening of the dollar that occurred after Paul Volcker came to the Fed and raised U.S. interest rates to the roof to fight inflation.

Suddenly the dollar was going up, and the people who worried about the value of their dollars were no longer interested, so the idea disappeared. But all the details were worked out, the idea is in place, and could be developed. So if we want to move in that direction it seems to me there are very plausible ways to do so, both in the short run, and over the longer run.

Evolution of Chiang Mai Initiative

I would repeat a point I made yesterday, which is my strong support for the continued evolution of the Chiang Mai Initiative, particularly in its multilateral form. I agree with Cheng Siwei. There is a complementarity between regionalism and globalism in these areas. An effective Chiang Mai could supplement global financial resources

for dealing with crises.

It obviously has to work out the terms and conditions and surveillance that it uses to monitor the use of its funds. But assuming that's done in a way consistent with global norms and institutional arrangements, it seems to me it's a wholly desirable idea.

Moreover, there is nothing more likely to galvanize effective evolution and activity by the International Monetary Fund than the fear that there might be created an Asian Monetary Fund that would rival it, or even take a lot of its membership away. I think that kind of healthy competition would be good both for the Asia-Pacific and for the world system.

Creating Movement on Trade

A similar point can be made about trade. Our global trading system is now basically at a standstill, with the collapse of the Doha Round. I think that is a very dangerous situation. If you do not move forward on trade, you do tend to be pulled back by the creation of vacuum. We're seeing it now in the world economy—abetted by the recession, of course—with the outbreak of trade protection in a lot of countries, including here in the United States as well as in most of the major G20 and Asian countries.

I would simply say, "I told you so." For a number of years, I had been proposing that APEC not put all its eggs in the Doha basket, that it proceed seriously toward a Free Trade Area of the Asia-Pacific, both to have a Plan B in case Doha failed and to provide, more importantly, a catalyst to Doha. The best way to get the WTO and Doha moving seriously is to threaten it with an alternative—a Free Trade Area of the Asia-Pacific [FTAAP].

A similar dynamic took place and brought the Uruguay round to a successful conclusion after three years of hiatus in the early 1990s. A similar dynamic could occur today. So, whether it's starting out with a Trans-Pacific Partnership, which is more limited, or reviving the whole idea of the FTAAP, I think that's got to be the next step for those who are serious about trying to move trade globalization back onto a positive path.

The G2 Concept

And my final point, underlying all this, is what I think is the most important and least understood institutional idea. Cheng Siwei mentioned it, and to my great pleasure, agreed with it in the context of global warming policy—namely, the creation of a very informal G2 between the United States and China. When I invented the idea of a G2 five years ago, the idea was not for the G2 to replace any of the other institutional mechanisms. It is not intended to replace the G7, or the G20, or the IMF, or anything else. The goal of the G2 is to strengthen those

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other institutions and make them work better.

The strategy would be for the biggest developed country and the biggest developing country to get together, work out strategies and agreements on major issues—particularly global warming or a new monetary base for the global economic system—so that when the broader groups meet, there is a foundation created by an agreement between the most important countries.

The people who've criticized the G2 have tended argue that it would be a nasty thing to replace groups that include Japan, Europe, and others. Of course, Japan, Europe, and others are essential to reach agreement and to carry forward strategies on all issues. But we never get to the broader groups unless the central players are themselves in agreement from the outset. Hopefully, with a clear understanding of what it means, I continue to believe that a G2 is an essential, necessary, but by no means sufficient condition to promote the kinds of reforms in all these areas.

So, a new economic order is underway, a lot more is needed, some promising steps have been taken, and a number of very interesting and exciting possibilities are on the agenda. I hope this meeting will help promote movement in those directions.

MASAHIRO KAWAI, Dean, Asian Development Bank Institute:

Dr. Kawai's PowerPoint presentation is available at http://www.pecc18.org/materials/kawai7_pecc.pdf

Following up Fred's presentation and Mr. Cheng's earlier remarks, I want to discuss global economic management and Asia's responsibility. I want to remind you of the importance of the rise of the BRICs, particularly, China and India, relative to the US, Europe, and Japan. **[Slide 1]** This red part is GDP up until 2050, projected by Goldman Sachs a few years ago. **[Slide 2]**

We have to make very serious assumptions about the future growth of these big economies, because of the potential constraints to growth. We shouldn't be taking these projections too seriously, but they give us some indication about the economic importance of China, India, and Asia. So, Fred's idea of the G2 appears very important for the future. China is catching up with Japan in about five years in terms of GDP, and will catch up to the United States in about 2040.

But if you take a look at per capita income **[Slide 3]**, China still is at the lower end. The per capita income differential is going to persist for a long time. The United States, Japan, and Europe, would be on top.

I want to begin my discussion with this as background. Slide 5 indicates that the rise of foreign exchange reserves, particularly China's, is quite astonishing. **[Slide 5]** Asian accumulation of foreign exchange reserves is a fact. This has potential implications for financial power of

China, and other Asian countries.

Also, rising carbon emissions. **[Slide 6]** Developing Asia's share of carbon emissions, of global emissions, would be rising from 30 percent in 2006 to more than 40 percent by 2030. So there are many challenges ahead of us.

Charles Morrison and a few other colleagues suggested that this session should be focus on the role of Asia in the management of global economy and global responsibilities of Asia. **[Slide 7]** We've had some discussions on global economic recovery and the financial stability.



Dr. Masahiro Kawai, Dean, Asian Development Bank Institute

China is leading the way. Of course, the balance of payments issue is a very serious and needs to be addressed.

Earlier, I heard Prof. Eswar Prasad say that he was not very optimistic about this. In addition, it is important to increase IMF resources and management effectiveness.

But as I said yesterday, Asia's a bit cynical about this because many Asian countries do not intend to come to the IMF for financial rescue. Governance reform is essential, the Doha Round has been stalled, climate change mitigation is critical. Asia's role in addressing all of these issues is important.

Changing Development Paradigm

The way Asia can make a significant contribution for the global community would be by pursuing a good strategy for Asia's own sake. This means Asia is going to have to change its development paradigm. **[Slide 8]** I'm going to talk about two shifts in development paradigm: a shift from export-led growth to domestic or regional demand-led growth; and a shift from a high- to low-carbon economy.

Developing Non-Tradeable Sector

Increased focus on consumption, investment, and social sector will be quite important, as will corporate governance reform, in the sense that the distribution of income is now being skewed in many Asian countries toward the corporate sector.

Corporate earnings and corporate savings do play a very important role, and this issue has to be addressed. Essentially, households should be getting more income.

Government policy has to be designed in such a way as to channel corporate retained earnings and corporate

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retained profits towards social spending or towards households.

The third focus would be on the development of the non-tradable or services sector. This means that Asia should continue to produce more, but at the same time, consume more. Asia has been a very strong economic player as the global factory, but Asia also has to become a global consumer. The way to do it is to develop non-tradable sectors in Asia.

Shift to Low-Carbon Economy

That also is related to the second shift: a shift from a high-carbon economy to a low-carbon economy. Here, the idea of decoupling and co-benefits would be quite important. Decoupling means that, while pursuing economic growth, carbon emissions can be reduced. That's really the idea; decouple the carbon emissions from economic growth. That's being pursued by Japan and Europe.

If Asian countries can see the value of environmental improvement for sustainable development in their own economies, then that strategy can contribute to climate change mitigation. That essentially is the co-benefit approach. In other words, don't take the climate change issue as something external, something imposed from the West, but internalize the issue within one's own economic development model.

Energy saving, energy efficiency, and environmental investment will all be very important. Some of these have a non-tradable services component, so this paradigm shift will be very beneficial for Asia and for the global community.

Asia's Role in G20

Fred talked about the importance of the G20 process, and I agree that the creation of the G20 process at the leaders' level is a very good development. [Slide 10] But so far, the G20 agenda seems to be set by the United States and Europe, not quite so much by emerging market. We have yet to see either the BRICs or the Asians getting together before the G20 meeting. They have to come up with a great idea of how to improve global economic system.

Asia's Role in IMF

IMF reform is needed, no question, and Asia's voice should rise. But, maybe only marginal changes are expected, as I said yesterday. Asians do not seem to have a strong sense of ownership of the IMF even though they are shareholders. In a sense, the IMF has been imposed on them from the outside. That perception has to change. Otherwise, even if IMF gets large resources and very flex-

ible lending facilities, it could be very difficult to sell the IMF itself to Asians. [Slide 11]

Climate Change Responsibilities

With respect to climate change, we have to clearly understand the differentiation of responsibilities, taking into account the fact that developed countries have been accumulating greenhouse gases but newcomers also have responsibility. For developing countries, per capita consumption of energy is still very low as are per capita greenhouse gas emissions.

Regional Institution-Building

With respect to regional institution building, I want to say that this is quite good, not only for Asia, but for the global community, because regional institutions are the vehicles through which regional economies can provide regional public goods. [Slide 12] In that sense, Asians have yet to really create more institutions and mechanisms through which they can work together.

I'm very glad to hear, once again, Fred's comment concerning the multilateralization provided by the Chiang Mai Initiative and its gradual move towards the creation of an Asian Monetary Fund with a surveillance

A large Asia-wide FTA would enable a sequenced global trade liberalization, at a time when the WTO process is not going very well

unit, and potentially, an Asian currency unit which is sort of an Asian version of the SDR. This would be a very useful arrangement for financial stability in Asia.

The Asian financial stability dialogue, which ADB has been suggesting for creation in Asia, would be very useful for financial sector stability at the regional level because not all Asian countries are members of the Financial Stability Board, which is a new institution succeeding the Financial Stability Forum.

Trade Debate

With respect to trade, a large Asia-wide FTA, whether it's based on ASEAN plus 3 or ASEAN plus 6, would be quite useful, perhaps before moving to a Asia-Pacific-wide FTA. The idea is that the Asians can consolidate their Asian FTA noodle bowls into a more coherent single one, and Asians can connect themselves by using this bigger FTA with North America or with Europeans. It would be a sort of sequenced global trade liberalization, at a

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time when the WTO process is not going very well.

Pan-Asian Infrastructure Forum

The Asia Development Bank also has suggested the creation of a pan-Asian infrastructure forum, to create a seamless Asia. We have just launched a book on a seamless Asia. But all of these efforts would require very strong collaboration between Japan and China. If Japan and China do not agree, these things cannot move.

Also important would be complementarity with global institutions, just as this diagram shows. [Slide 13] ASEAN is really the center and then ASEAN plus 3, the East-Asia Summit, and APEC grow from it. APEC, in particular, is a very important forum for Asians, because it's really the only multilateral forum where Asians and North Americans, in particular, U.S. officials, can talk with each other. At the same time, Asians do have ASEM, a Asia-Europe meeting. So, this is really the Asian view of various organizations.

So, finally, I'd like to explore APEC, US, and Asia. [Slide 14] What should be the key transpacific agendas? The first would be facilitating the resolution of transpacific payments imbalance. We have had this discussion these past two days, and Asia-Pacific experts agree that a new deal potentially would be a very important initiative. International support is needed to encourage many developing Asian economies to undertake a significant paradigm change, in terms of financing, technology transfers and capacity building for green infrastructural development.

Finally, an initiative to protect the social sector would be very important. It's a very important challenge for many Asian countries to pursue socially sustainable growth, and stronger social sector protection is the basis for healthy household consumption. Thank you.

QUESTION & ANSWER PERIOD

CHARLES MORRISON: I'm going to put one thing on the table, and then I'll go around and ask for other questions and comments before I ask the panelists to respond.

Masahiro said that Asians didn't really feel ownership in the G20 process. In many ways, he promoted Asian-only institutions, in part to provide regional public goods, but also, I think you were implying that it's hard for Asians to get their act together if they're in the institutions with outsiders.

Fred was very strong in supporting the Chiang Mai Initiative as an Asian initiative. He didn't say so today, but having heard him on other occasions, and I think he would not be so enthusiastic about the Asia-only free trade area as the most effective free-trade area. Now I'll open the questions to the floor.

[UNIDENTIFIED]: I have two issues. First, how do we go about resolving the difficulty relating to the lobbying interests that are real in the developing as well as the developed world? Second, how do we go about reconciling the values that undergird our policies in the devel-



From left, Dr. Charles E. Morrison, President, East-West Center; Dr. C. Fred Bergsten, Director, Peterson Institute for International Economics; Dr. Masahiro Kawai, Dean, Asian Development Bank Institute

oped as well as the underdeveloped world?

I'm specifically thinking about the food crisis we have, where after 2005, 83 percent of the price of our food is up, and one-half of the population of the world is in Asia. Even though the increase of the price of food directly stems from the economic rise of Asia, there still are a lot of poor people in Asia.

RANDALL HENNING, Peterson Institute for International Economics and American University: I wanted to follow up on Dr. Kawai's comments about the nature of the G20. He said that the G20 reflects the agenda items and preferences of the United States and Europe, and not the interests of Asian countries so much. What issues should be on the G20 agenda that respond to Asian concerns?

YUN-WING SUNG, Chairman of Hong Kong Committee for Pacific Economic Cooperation: Though Asia would not play much of a role in the new financial regulation that is to come, is there some statement we can make about the new financial order?

SOOGIL YOUNG, President, National Strategy Institute of Korea: I have two questions. The first one is for Fred Bergsten. You proposed that in order to keep the trade liberalization bicycle move forward, we might just as well press the FTAAP as a plan B. Do you think the FTAAP is more doable than the Doha Round itself, given the problems over agriculture and so forth, which are common obstacles in both rounds?

A related question—do you think ratification of Korea-US FTA could also serve as forward momentum? Some experts have proposed that once the U.S.-Korea

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FTA is ratified, it will trigger an FTA between Japan and Korea, which could lead to a US-Japan-Korea FTA. After that, ASEAN countries may want to join, and so may China. So there can be an expansive evolution, to create a forward momentum of a global dimension.

Another question is addressed to both of you. Both of you, agree that it is good to keep the CMI process further evolved and developed, as accompaniment for the IMF. Now, I understand that there is concern in Washington that when the CMI further evolves toward IMF, its conditionality could be detached from that of IMF, which could lead to the collapse of the IMF. I understand that Dr. Kawai has a different view. You were arguing for the de-linking between the two. I wonder whether you can explain that?

RICHARD DROBNICK, Director, Center for Global Business Excellence, Marshall School of Business, University of Southern California: A question to Professor Kawai: On your last slide, the first bullet point was, "There needs to be a resolution between the imbalances between Asia and the United States." Could you explain that or define it a little more clearly, what you mean by "resolution of the imbalances?"

BILL FRYMOYER, Washington, D.C.: What's the best sequencing of TPP/broader Asia free trade initiatives for the United States? When should we engage in that front? How do we reengage Americans on the broad issue of free trade with Asia?

HSIEH CHIEH-CHI, PECC Youth Delegate, Chinese Taipei: I have two questions for Dr. Bergsten. You spoke a lot about the Chiang Mai Initiative and how much you are in favor of it. If the Chiang Mai Initiative becomes really effective and the IMF falls behind the pace of its reform, would an AMF be possible, and if so, what would the interaction between IMF and possible AMF be?

Secondly, over the past two days, we have talked about integration and the fact that the economic crisis would actually accelerate this integration, not only in north Asia, but already in Southeast Asia. We have the Asian currency unit. Could this develop into an Asian dollar in the near future? Also, Chinese Taipei is not one of the Asian +1, +3 systems, but there are good and friendly relations between China and Chinese Taipei these past years. I was wondering if there are some approaches for us to be considered not only in the Asia's currency unit, but also in the Chiang Mai Initiative?

CHARLES MORRISON: Well thank you very much. The panelists actually have too many questions to answer in five minutes each. But they will do the best they can, picking out the questions that they feel are most appropriate. So, let's go ahead, and this time, we'll start with

Masahiro, and then we'll to Fred for the last word.

MASAHIRO KAWAI: On the food price issue, I think it's very important for all countries to focus on productivity growth. That's the most important part. Now, with regard to the poor, I think several Asian countries have been developing direct cash transfer programs, which is very good. At the time of the Asian financial crisis more than 10 years ago, governments did not have a good system of this sort, and the collapse and disappearance of money from the central government to the household was an issue. So, in that sense, many countries are making good progress.

G20 Agenda

Regarding Randy Henning's question about the G20 agenda, one of the surprises to me about the most recent G20 meeting, was that there was not much discussion about the need of the United States and Europe to resolve the financial system crisis. There was a lot of talk about fiscal policy, and IMF supervisory reform.

But the most important concern for many Asian countries, and the rest of the world, is to see the resolution of crisis as quickly as possible in the United States and in Europe. This did not come out. There was a great deal of dissatisfaction on the part of many Asian countries. Asian countries can bring various types of regional initiatives to serve as important building blocks for global economic and financial management. That sort of input, I think, would be quite useful.

Financial Regulation

Financial sector issue, regulatory issue, I think essentially harmonization and integration—market integration, in particular, focusing on the bond markets. In the case of the banking system, supervisory and regulatory harmonization is something that many Asian countries ought to be pursuing.

Trade Agreement Sequencing

On the best sequencing for free trade agreements with Asia, the United States first must sign the Treaty of Amity and Cooperation with ASEAN, which will enable Washington to join the ASEAN-plus process and lay the groundwork for an ASEAN plus United States FTA

You know, ASEAN has been developing ASEAN plus 1 FTAs. ASEAN plus China, ASEAN plus Korea, ASEAN plus Japan, ASEAN plus India, ASEAN plus Australia and New Zealand, and now we are negotiating an ASEAN plus EU. An ASEAN plus US FTA would be a very important process, and indicate recognition on the part of the United States of ASEAN's role as Asia's hub.

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Asian Monetary Fund

I think an AMF is possible, and the creation of the Asian currency unit is now possible, once CMI multilateralization has been agreed. The reason is that the +3 countries have to decide their shares.

Asian Currency Unit

In the case of Asian currency unit, it's a basket of ASEAN plus 3 currencies. China, Japan, and Korea have to decide the shares in the currency. Now, they decided on contributions to the Chiang Mai Initiative, and the shares decided by Japan, China, and Korea, are quite reasonable shares for constructing an Asian currency unit. So, I don't think there is a political impediment to the creation of an Asian currency unit. But to transition from an Asian currency unit to the Asian dollar would be a huge leap.

FRED BERGSTEN: Let me start by saying that I applaud and strongly support virtually everything that Kawai-san said in his remarks. His suggestion that the change in the growth paradigm in Asia could be its major

The Obama administration's domestic policy reforms will be enormously helpful in providing a stronger foundation for trade policy

contribution to future global financial stability and economic progress, I think is exactly right. That's the answer to the question about the imbalances. It's to alter the growth and development paradigm in Asia in exactly the directions that Hiro talked about.

Complementary U.S. Actions

As I said yesterday, the United States has to take complementary steps to change its growth paradigm: less consumption, more saving, fewer budget deficits, more private investment, more export-led in the US, less export-led in Asia. All of these changes would reduce those imbalances.

G20 Agenda/Asia

I would've asked the same question that my colleague Randy Henning did about the G20 agenda. My argument at the outset today was that the G20 provides the opportunity for Asia to play an equal role in global economic leadership, particularly with Korea in the chair

next year. I happen to share Hiro's frustration that the London summit did not do more on the financial stability issues. I think the reason, however, is an institutional reason.

Central Bank Role

A very large part of the policy response to the current financial stability questions must be taken by central banks. Central banks are famously independent. They do not take orders from governments, and governments have learned it's counterproductive to stand up at summit meetings and try to tell them what to do. And I think that was a big part of the problem.

Now, I don't say that our treasuries don't have some role. Obviously, they do and that part of it could be discussed. But I think the absence of central banks at the summit level actually is an important impediment in being able to pursue those discussions in the ways that you and I would both like to see.

Trade Prospects

Let me take most of my few minutes, though, to respond to the trade questions. Soogil, in a way, asked the fundamental question, when he asked, "Can or will the United States do any of this stuff?" The Obama administration came into office hoping to avoid trade issues. The Democratic Party is very divided on trade. The administration has a huge agenda, and it hoped, at a minimum, to defer the trade issues to a later day.

We know the backlash against globalization in the United States has been gathering for at least 15 years. It's going to require a lot of reform in our domestic programs to respond to the concerns about worsening income distribution, job insecurity, stagnant median wages, and the like. That was the starting point for our new administration.

Fortunately, it was not permitted to avoid trade issues. The very first piece of legislation it confronted was its own fiscal stimulus bill—which was immediately amended to include very protectionist steps in the Congress. The administration, to its great credit, responded forcefully against putting new protectionism into U.S. government procurement and was able to prevail on that in the Congress.

So, I think the administration, forced by events, has, in fact, started to go halfway down the trade policy path. When President Obama speaks at summits and resists backsliding of U.S. policy toward protection, I think he's absolutely sincere and committed, and will succeed. But what the administration has not yet done is decide how and even whether it wants to move forward on trade policy toward more liberalization.

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U.S. Domestic Policy Reforms

I'm actually optimistic about the prospects in the next year or two for two reasons. One, is that the Obama administration's domestic policy reforms will be enormously helpful in providing a stronger foundation for trade policy.

I have been saying for the last three or four years that the most important trade policy steps the United States can now take have nothing to do with trade, but have to do with putting in place better domestic safety nets, better domestic empowerment programs to enable our workers to take advantage of globalization, rather than feel victimized by it.

Until we put those building blocks in place, it's going to be very hard to overcome the backlash against globalization—intensified, of course, by the rising unemployment with the recession—and provide a fundamental foundation for constructive U.S. trade policy.

Fortunately, in the stimulus bill there was a sweeping reform of trade adjustment assistance that tripled its budgetary amounts, dramatically increased its training programs. It includes everything those of us who've advocated trade adjustment assistance improvement for the last ten years have called for.

Healthcare reform is now being actively debated. If the Obama administration succeeds in extending health-care coverage to those 50 million Americans not covered at all by insurance, if it succeeds in detaching health coverage from employment, and thereby makes health insurance portable, not linked to a job and therefore susceptible to job loss, those domestic changes will have a huge impact in providing a political foundation for an outgoing and constructive U.S. trade policy.

We're also reforming unemployment insurance, make it more generous and flexible in its implementation. So there are lots of domestic changes that will improve the situation, but it'll take time to get them in place.

Obama Foreign Policy Reforms

The second reason for my optimism pertains to the Obama administration's foreign policy. The Obama foreign policy seeks to, and I quote, reverse the Bush legacy, restore US standing in the world, restore a multilateral focus, and international cooperation writ large. As all of you know, that would be impossible without cooperation on international economic, and particularly, trade issues.

So, the foreign policy imperative, along with these domestic reforms, will bring the Obama administration and U.S. trade policy back into constructive cooperation and onto what I would regard as a constructive track. But it will take a little time.

Paths for Trade Liberalization

Concerning Soogil's second question about the best path for trade liberalization, the neatest path to Asia-Pacific trade liberalization would, of course, be a FTAAP. Likewise, the straightforward, simple path toward East Asian economic and trade liberalization would be an East Asian Free Trade Area.

But in the real world, nothing quite so neat and simple is taking place. In Asia, what we see is the series of 10+1s, which are not yet complete or in any way congealed into an East Asia free trade area.

What we see across the Pacific is a hodgepodge of transoceanic FTAs; some regional, some bilateral, Kawai-san now says there should be a US-ASEAN FTA. Well, George Bush proposed a US-ASEAN free trade agreement. The United States began to pursue that with bilateral trade agreements. There are suspended U.S. negotiations with Thailand and Malaysia.

*We should pursue Asian trade integration,
but in parallel with Asia-Pacific trade
liberalization*

There is, of course, an agreement in place with Singapore and Australia. As Soogil mentioned, the US-Korea FTA has been negotiated, and we've always assumed that it would lead to a US-Japan FTA once in place. It's hung up in our Congress. I suspect it will be passed probably next year.

U.S.-KORUS Implications

But I think Soogil's right that the U.S.-Korea ratification and implementation would then probably trigger US-Japan FTA negotiations. It also probably would also trigger Korean and then Japanese participation in the trans-Pacific partnership [TPP] stepping stone toward a free trade agreement for the Asia-Pacific as a whole.

So, it's a process of competitive liberalization. If the United States and Korea get together, Japan's going to insist on a U.S.-Japan FTA. If the U.S.-Korea and U.S.-Japan get together, I'm not sure China will be so happy to be discriminated against in the markets of its three biggest trading partners, and so even China might then say, better have some kind of FTAAP. So, there are many paths, and they always turn on the politics of the moment, and what seems most feasible.

A U.S.-Indonesia FTA? As [Indonesian Trade Minister] Mari Pangestu well knows, the Peterson Institute did a major study of a U.S.-Indonesian free trade agreement. At one point, the Indonesians were thinking

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of pursuing that after their FTA with Japan was concluded. This hasn't happened yet, but it serves as another example of competitive liberalization.

Competitive Liberalization

What those of us who invented competitive liberalization have been trying to promote for a very long time is that all this progression leads us, eventually, to a world of free trade. At the end of the day, you get global liberalization that approximates free trade as much as the real world could ever do. And it turns out that in the real world it seems more feasible to reach that ultimate objective through this messy process of bilateral, sub-regional, and regional agreements, than through the obviously logical frontal approach of having a WTO round whose goal is to eliminate all barriers around the world.

That kind of WTO round doesn't seem very likely. But these other steps have already achieved enormous progress in moving in the right direction. There has been some backsliding along the way and some problems like conflicting rules of origin, but on the whole the bicycle has continued to move, the world has continued to liberalize, growth has been promoted, development has been expanded, and the bottom line has been a very positive one, which I hope will continue.

So Soogil, I don't give you a very clear and precise blueprint, but I do think that within the next year or so as the U.S. administration achieves the payoff from the domestic reforms and the foreign policy imperatives that I mentioned, the United States will be back in the trade game in a very big way.

East Asian Trade Agreements

One important final point concerns one word in Dr. Kawai's original presentation with which I disagree. It's when he said that we in Asia should proceed with our East Asian agreement before we do an Asia-Pacific agreement. Again, unlike many American economists, I support East Asian trade integration. My answer to Charles' question is, no, I support East Asian trade agreements, the same way I support the Chiang Mai Initiative on finance.

But in both cases, I think they need to be implemented in a way that is fully consistent with the relationships across the Pacific, and indeed, the broader global relationships of the Asian countries. In the trade area, I fear that a truly Asian bloc, even if created in these messy ways, will discriminate very substantially against U.S. trade and will lead to further backlash in U.S. politics, including in our Congress, which will spill over into the security area as well as the economic area.

Therefore, what we should do is pursue Asian trade

integration, but in parallel with Asia-Pacific trade liberalization. I believe the two should proceed along similar tracks at the same time, reinforcing each other, pushing each other, galvanizing each other. But not having the Asian bloc created first in a way that may or may not ever lead to the second step 20 years later. That's my one caveat, but I think it's important.

As the competitive liberalization process moves ahead, we should try to proceed on as many parallel fronts as possible, but keep our eye on the ultimate ball of liberalizing trade among all of our countries, as far and as fast as possible.

CHARLES MORRISON: We can't possibly summarize this, except to say that I think we all agree that out of crises come opportunities, that there are changes in the wind, that it's still an open question whether we'll get the job done right, but in a crisis situation, it's imperative that we do get the job done right. Thank you very much. ♦